

IC 01-1

Tax Type: Invested Capital Tax

Issue: Invested Capital Tax (Long Term Debt)

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS**

THE DEPARTMENT OF REVENUE)	Docket No. 95-ST-0000
OF THE STATE OF ILLINOIS)	97-ST-0000
)	98-ST-0000
v.)	
)	IBT # 0000-0000
"CONSOLIDATED POWER COMPANY")	Barbara S. Rowe
Taxpayer)	Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Owen E. MacBride, Scott C. Tomassi, and Laura B. Weinberg of Schiff, Hardin & Waite for Consolidated Power Company; Charles Hickman, Michael Coveny, and Jim Day, Special Assistant Attorneys General, for the Department of Revenue of the State of Illinois;.

Synopsis:

The Illinois Department of Revenue (hereinafter referred to as the "Department") audited "Consolidated Power Company" (hereinafter referred to as "CPC" or the "taxpayer") for the years 1989 through 1996 and issued Notices of Tax Liability (hereinafter referred to as "NTLs") proposing adjustments to "CPC"'s Invested Capital Tax under the Gas Revenue Tax Act (hereinafter referred to as the "GRTA")¹ (35 ILCS 615/1 *et seq.*). "CPC" timely protested the NTLs for all the years except 1991.² A hearing was held during which the taxpayer presented the following issues:

¹ For a list of acronyms used in this recommendation, please see attached appendix at page 46.

² For the 1991 assessment, the taxpayer filed a protest action in the circuit court of Cook County pursuant to the State Officers and Employees Money Disposition Act (30 ILCS 230/1 *et seq.*).

- (1) whether the present value of future lease payments under the taxpayer's capital lease obligations for periods beyond the current year is "long-term debt" under the GRTA;
- (2) whether the Department is precluded by §5-10 of the Administrative Procedure Act (hereinafter referred to as the "APA") (5 ILCS 100/5-10) from including the taxpayer's capital lease obligations in "long-term debt" because the Department failed to adopt a rule concerning its position;
- (3) whether the Department is precluded by §3 of the Illinois Department of Revenue Sunshine Act (20 ILCS 2515/3) from including the taxpayer's capital lease obligations in "long-term debt" because the Department issued an informal ruling, opinion, or letter concerning its position but failed to adopt it as a rule;
- (4) whether the Department is precluded by §4(c) of the Taxpayers' Bill of Rights Act (20 ILCS 2520/4(c) and 86 Ill.Admin.Code §205.20(c) from assessing the additional tax because the taxpayer relied on erroneous written advice contained in the Department's GRTA return, which did not specify that obligations under capital leases should be included as "long-term debt";
- (5) whether the Department is estopped from imposing the additional tax because the Department's failure to timely articulate its position precluded the taxpayer from obtaining recovery of the additional expense through its regulated rates charged to its customers; and
- (6) whether the taxpayer is entitled to credit memoranda or refunds if it prevails on the capital lease issue.

After reviewing the record, for the following reasons it is recommended that this matter be resolved in favor of the taxpayer regarding the issue of whether the non-current portions of the capital lease obligations are "long-term debt" for the purposes of the Invested Capital Tax. It is further recommended that this matter be resolved in favor of the Department regarding the issuance of credit memoranda, even though the taxpayer prevailed on the capital lease issue.

FINDINGS OF FACT:

1. "CPC" was incorporated as "Consolidated Power & Light Corp". on April 15, 1935, and has operated under the name "Consolidated Power Company" since June 1, 1940.
(Stip. #1)

2. The taxpayer is engaged in the business of distributing, supplying, furnishing, or selling electricity and gas to persons for use or consumption and not for resale. (Stip. #2; Tr. p. 11³)

3. The taxpayer is a "public utility" as defined in §3-105 of the Illinois Public Utilities Act (220 ILCS 5/3-105). (Stip. #2; Tr. p. 11)

4. The taxpayer is regulated by both the Federal Energy Regulatory Commission, (hereinafter referred to as the "FERC") and the Illinois Commerce Commission (hereinafter referred to as the "ICC.") (Tr. p. 11)

5. As a public utility, "CPC" is regulated by the ICC as to its rates, terms and conditions of services, as well as numerous other aspects of its business. "CPC" cannot charge any rate for its service to its customers that is in excess of that allowed by the ICC. (Stip. #3)

6. "CPC's" ability to meet the expenses related to the provision of services to its customers, to make capital investments for the maintenance, expansion and enhancement of systems and services to customers, to declare dividends among other business decisions, and to make a reasonable profit from its electric and gas service operations is governed by the State of Illinois, through the ICC. (Stip. #3)

7. Companies subject to rate regulation account for certain transactions differently than unregulated companies. Most of these differences can be attributed directly to the peculiarities of the rate-making process in which government agencies have the authority to permit, defer, or deny the recognition of revenues and costs in establishing rates. (Tr. p. 524)

³ The hearing in this matter extended over a period of 5 days. Although the transcript is in 5 volumes, all the pages are numbered consecutively. Therefore, only the transcript page number is necessary.

8. A rate case is a proceeding in which a utility company presents its operating expenses and its rate base and the regulatory agency determines the revenue requirements and prices to be charged to the utility's customers. (Tr. p. 17)

9. The rate base of a utility is essentially the property, plant, and equipment in which the utility has invested in order to serve its customers. It is a collection of assets that the company has put into service to serve its retail customers for electrical purposes. It is the net book cost of those assets. (Tr. pp. 17, 140)

10. The revenue requirements of a utility is the level of revenue collected from the utility's customers that would be sufficient to cover operating expenses, provide a return on a rate base or investment in a rate base, pay income taxes, and provide a reasonable return to investors. (Tr. p. 141)

11. "CPC" has been a taxpayer under the Public Utilities Revenue Act (hereinafter referred to as the "PURA") (35 **ILCS** 620/1 *et seq.*) from the effective date of the PURA in 1937. (Stip. #5)

12. "CPC" has been a taxpayer under the GRTA (35 **ILCS** 615/1 *et seq.*) from the effective date of the Act in 1945. (Stip. #4)

13. "CPC" has been a taxpayer under the additional Invested Capital Tax provisions of the GRTA from the effective date of the Invested Capital Tax provisions in 1979. (35 **ILCS** 615/2a.1) (Stip. #4)

14. The Invested Capital Tax was enacted as one of the replacement taxes for ad valorem personal property taxes in accordance with the requirements of Article IX, §5(c) of the Constitution of 1970. (Stip. #15)

15. The Invested Capital Tax was imposed solely on public utilities regulated by the

ICC. (Stip. #15)

16. The Invested Capital Tax was imposed on gas public utilities by §2a.1 of the GRTA and on electric public utilities by §2a.1 of the PURA. In accordance with §2a.1 of the PURA, "CPC" files returns under the GRTA for the invested capital of both its electric and gas utility operations. (Stip. #16)

17. During the period of 1979 through 1996, "CPC" owned and operated the "ABC" Power Station, which is an electric generating facility located in "Nameless" County, Illinois. The "ABC" Power Station uses nuclear fuel in the generation of electricity. (Stip. #25)

18. As of February 2, 1981, the taxpayer has leased nuclear fuel from "Consolidated Power Fuel Company" (hereinafter referred to as the "CPFC") pursuant to a Nuclear Fuel Lease Agreement (hereinafter referred to as the "Fuel Lease") between the taxpayer as lessee and "CPFC as lessor. (Stip. #6; "CPC" Ex. #85)

19. For accounting purposes, the lessee of a lease classifies the lease as either an operating lease or a capital lease. (Tr. p. 27)

20. Prior to 1976, all lessees recorded their leases as operating leases. (Stip. #54, 55)

21. In November 1976, the Financial Accounting Standards Board (hereinafter referred to as the "FASB") issued Statement of Financial Accounting Standards (hereinafter referred to as the "SFAS") No. 13, "Accounting for Leases." (Stip. #54; "CPC" Ex. #79)

22. SFAS No. 13 was issued in response to the increased use of leasing as a means of financing the purchase of assets. The purpose of SFAS No. 13 was to obtain symmetry in reporting between lessor and lessee and to enhance comparability of financial statements. (Tr. pp. 385-386, 413)

23. SFAS No. 13 sets out four criteria for determining whether a lease is a capital or

an operating lease. If a lease meets one or more of the four criteria, it is to be recorded by the lessee as a "capital lease" on the asset side of the balance sheet and as an "obligation under capital leases" on the liability side. (Stip. #55; "CPC" Ex. #79; Tr. pp. 26, 66)

24. The criteria set forth in SFAS No. 13 for classifying a lease as a capital lease are as follows: (1) the lease transfers ownership of the property to the lessee by the end of the lease term; (2) the lease contains a bargain purchase option; (3) the lease term is equal to 75% or more of the estimated economic life of the leased property; or (4) the present value of the lease payments equals or exceeds 90% of the fair market value of the leased property at the inception of the lease. ("CPC" Ex. #79)

25. SFAS No. 13 ¶ 13 states that "Assets recorded under capital leases and the accumulated amortization thereon shall be separately identified in the lessee's balance sheet or in the footnotes thereto." The related obligations should be separately identified in the balance sheets as obligations under capital leases and shall be subject to the same considerations as other obligations in classifying them as current and non-current liabilities. ("CPC". Ex. # 79; Tr. pp. 500-501)

26. For purposes of SFAS No. 13, leases other than capital leases are classified as operating leases. Normally, rent on an operating lease is charged to an expense account over the lease term as it becomes payable. ("CPC" Ex. #79)

27. The Nuclear Fuel Lease Agreement between the taxpayer and "CPFC meets the third and fourth criteria listed in SFAS No. 13 and therefore is considered a capital lease. ("CPC" Ex. # 79; Tr. pp. 66-67).

28. SFAS No. 13 does not require the noncurrent portion of an entity's obligations to be reported as long-term debt on the lessee's balance sheet. (Stip. #60)

29. SFAS No. 13 does not require the noncurrent portion of an entity's obligations under capital leases be recorded as long-term debt. (Stip. #61)

30. SFAS No. 13 does not require the noncurrent portion of an entity's obligations to be classified as long-term debt. (Stip. #62)

31. In 1976, public utilities (including the taxpayer) did not comply with SFAS No. 13 because the provisions of the Addendum to Accounting Principles Bulletin (hereinafter referred to as the "APB") No. 2 required that regulated businesses follow the accounting guidelines of the regulatory authority. (Stip. #54; Tr. pp. 39-40)

32. The taxpayer is required to comply with the accounting guidelines of the ICC and FERC Uniform System of Accounts. The ICC Uniform System of Accounts is adopted and imposed pursuant to 220 ILCS 5/5-102 and the FERC Uniform System of Accounts is adopted and imposed pursuant to 16 USC §825. (Stip. #34; "CPC" Ex. #82)

33. The ICC Uniform System of Accounts for Electric Utilities (83 Ill.Admin.Code 415) adopts the FERC Uniform System of Accounts (18 CFR Part 101) as the ICC's Uniform System of Accounts. The provisions of the FERC Uniform System of Accounts described below are also included in the ICC Uniform System of Accounts for Electric Utilities. (Stip. #35)

34. The statutes authorizing the establishment of Uniform System of Accounts by regulatory agencies usually do not refer to Generally Accepted Accounting Principles (hereinafter referred to as "GAAP"). Accounting prescribed by the Uniform System of Accounts conforms in the most part to the Financial Accounting Standards issued by the FASB. The FERC goes through rule-making procedures before modifying their Uniform System of Accounts to incorporate new accounting pronouncements. (Tr. p. 525)

35. The FERC does not provide for capitalization of leases in the Uniform System of

Accounts. Each lease payment is charged entirely as rental expense resulting in a constant expense and cost of service charge over the life of the lease. This treatment creates a smoothing effect of the utility rates and allows FERC-regulated utilities to finance capital expenditures without increasing the rate base for long-term debt. The effect on long-term debt is particularly important for utilities whose ratio of debt to capital structure is limited by law or regulation. (Tr. p. 526)

36. Practice is varied among utilities with regard to the reporting of capital lease obligations in their annual reports. (Tr. p. 280)

37. The accounting for capital leases under the Uniform System of Accounts provides that lease payments are to be accounted for as rental payments and not separated between interest and principle payments. (Tr. pp. 30-31)

38. The ICC has not included the taxpayer's nuclear fuel lease in the taxpayer's rate base as an asset in determining the overall revenue requirements because the taxpayer is getting full cost recovery of the fuel lease through the fuel adjustment clause. The taxpayer has never asked the ICC to include the fuel lease in the rate base. The lease specifically states that the taxpayer should include rent payable to the fuel company under the lease in the fuel adjustment clause. (Tr. pp. 142-143)

39. The fuel adjustment clause, based on an ICC regulation, is a mechanism by which a utility company is allowed to flow through its actual cost of fuel to customers. As the utility company experiences increases or decreases in its cost of fuel to generate electricity, it collects the actual cost from its customers on a month-by-month basis. (Tr. pp. 18-19)

40. The ICC typically conducts proceedings on the taxpayer's fuel adjustment charge on an annual basis. (Tr. p. 19)

41. The FERC Uniform System of Accounts, Definition no. 15, defines “Lease, capital” as “a lease of property used in utility or nonutility operations, which meets one of [sic] more of the criteria stated in General Instruction 19.” (Stip. #36; "CPC". Ex. #82; Tr. pp. 29-30)

42. The FERC Uniform System of Accounts, General Instruction 19, “Criteria for classifying leases,” is substantially identical to the criteria for classifying leases set forth in SFAS No. 13. (Stip. #37; "CPC". Ex. #82; Tr. pp. 29-30)

43. The FERC Uniform System of Accounts, General Instruction 20, “Accounting for leases,” provides as follows:

- a. Leases required to be classified as capital leases were required to be so classified beginning January 1, 1984, except for leases with inception dates prior to January 1, 1983, for which capital lease accounting was required beginning with periods ending after December 31, 1986.
- b. A utility shall record a capital lease as an asset in either Property under Capital Leases (Account 101.1), Nuclear Fuel under Capital Leases (Account 120.6), or Nonutility Property (Account 121), as appropriate, and an obligation in either Obligations under Capital Leases – Noncurrent (Account 227), or Obligations under Capital Leases – Current (Account 243), at an amount equal to the present value at the beginning of the lease term of minimum lease payments during the lease term, excluding that portion of the lease payments representing executory costs such as insurance, maintenance and taxes to be paid by the lessor, together with any profit thereon. (Stip. #38)

44. The FERC Uniform System of Accounts defines Obligations under Capital Leases – Noncurrent (Account 227) as follows: “This account shall include the portion not due within

one year, of the obligations recorded for the amounts applicable to leased property recorded as assets in account 101.1, Property under Capital Leases, account 120.6, Nuclear Fuel under Capital Leases, or account 121, Nonutility Property.” (Stip. #39)

45. Prior to 1984, "CPC" was not required to record capital leases as assets or to record obligations under capital leases as liabilities, under either the ICC or FERC Uniform System of Accounts. (Stip. #40; Tr. pp. 40-41)

46. Prior to 1987, "CPC" was not required to record the Fuel Lease as an asset or to record obligations under the Fuel Lease as liabilities, under either the ICC or FERC Uniform System of Accounts. (Stip. #40)

47. "CPC" has properly recorded the noncurrent portion of its obligations under capital leases in Obligations under Capital Leases – Noncurrent (Account 227), in each of the years 1984 through 1996. (Stip. #41)

48. The FERC Uniform System of Accounts, Balance Sheet Chart of Accounts, includes Obligations under capital leases – noncurrent (Account 227), in the category “Other Noncurrent Liabilities.” (Stip. #42)

49. The FERC Uniform System of Accounts, Balance Sheet Chart of Accounts, includes the following accounts in the category “Long-Term Debt”:

- Bonds (221);
- Reacquired bonds (Major only) (222);
- Advances from associated companies (223);
- Other long-term debt (224);
- Unamortized premium on long-term debt (225); and
- Unamortized discount on long-term debt (226). (Stip. #43)

50. The FERC Uniform System of Accounts defines Other long-term debt (Account 224), as follows: “This account shall include, until maturity all long-term debt not otherwise provided for. This covers such items as receivers’ certificates, real estate mortgages executed or assumed, assessments for public improvements, notes and unsecured certificates of indebtedness not owned by associated companies, receipts outstanding for long-term debt, and other obligations maturing more than one year from date of issue or assumption.” (Stip. #44)

51. "CPC" is required to submit annual reports to the ICC using a form prescribed by the ICC. The ICC’s authority to require the filing of an annual report is provided in 220 ILCS 5/5-109. (Stip. #45)

52. The General Instructions to the ICC Annual Report state: “This form of annual report is prepared in conformity with the applicable Uniform System of Accounts and all of the accounting terminology used herein is in accordance therewith.” (Stip. #46)

53. The forms for the Balance Sheet in the ICC Annual Report, in effect for the years 1984 through 1996, listed “Obligations Under Capital Leases – Noncurrent (227)” under the category “Other Noncurrent Liabilities.” (Stip. #47)

54. The forms for the Balance Sheet in the ICC Annual Report, in effect for the years 1984 through 1996, listed the following accounts as line items under the category “Long-Term Debt”:

- Bonds (221);
- (Less) Reacquired Bonds (222);
- Advances from Associated Companies (223);
- Other Long-Term Debt (224);
- Unamortized Premium on Long-Term Debt (225);

- (Less) Unamortized Discount on Long-Term Debt – Debit (226);
- Total Long-Term Debt (total of above lines). (Stip. #48)

55. Prior to 1984, the forms for the Balance Sheet in the ICC Annual Report contained no provision for reporting capital leases as assets or for reporting obligations under capital leases as liabilities. (Stip. #49)

56. In each of the years 1984 through 1996, the taxpayer properly reported the noncurrent portion of its obligations under capital leases in “Obligations under Capital Leases – Noncurrent,” (Account 227) on the Balance Sheets in its Annual Reports to the ICC. (Stip. #50)

57. Under the FERC and the ICC Uniform System of Accounts, the noncurrent portion of a capital lease obligation is not recorded in the balance sheet category “Long-Term Debt.” (Stip. #51)

58. The Department audited the taxpayer’s Invested Capital Tax returns for the years 1979 through 1996. (Stip. #111)

59. In December 1982, the FASB issued SFAS No. 71, “Accounting for the Effects of Certain Types of Regulation.” SFAS No. 71 requires public utilities to record those leases meeting the criteria of SFAS No. 13 as capital leases. The new requirements were effective December 15, 1986, for leases whose inception was prior to December 31, 1982, and effective December 15, 1983, for leases whose inception was after December 31, 1982 (Stip. #56; “CPC” Ex. #80; Tr. pp. 41-43)

60. Prior to the implementation of SFAS No. 71, all leases were recorded by the taxpayer as operating leases. (Stip. #59)

61. The foundation for the issuance of SFAS No. 71 was the fact that there is a cause-and-effect relationship between the ratemaking process and financial reporting and recovery of

costs, and the statement sets forth the criteria as to how those economic effects should be reported in financial statements. (Tr. p. 219)

62. "CPFC is a subsidiary of the taxpayer, formed to purchase and own nuclear fuel, process it, and lease it back to the taxpayer. (Tr. p. 91)

63. "CPFC is 50% owned by the taxpayer, and 50% owned by an undisclosed not-for-profit entity. The taxpayer negotiates the acquisition of the raw material from which the nuclear fuel is fabricated and purchases the raw uranium. (Tr. pp. 91-92)

64. "CPFC does not have any offices. Employees of the taxpayer manage the business affairs of "CPFC. Employees of the taxpayer control and manage the fuel from the date the raw material is acquired until the fuel is spent. Interest expense, administrative, legal, accounting and other operating expenses and taxes incurred by "CPFC are billed to the taxpayer under the terms of the lease. ("CPC" Ex. #85; Tr. pp. 92-99, 101)

65. According to the terms of the lease, as long as the lease is in effect, the taxpayer has the right to purchase all or any portion of the nuclear fuel. If the contract/lease terminates for any reason, the taxpayer has an obligation to purchase the fuel from "CPFC. ("CPC" Ex. #85; Tr. pp. 99-101)

66. "CPFC finances the acquisition of the fuel through commercial paper as a short-term debt. Employees of the taxpayer make arrangements for the acquisition. (Tr. p. 165)

67. One of the reasons that the taxpayer chose to finance its acquisition of nuclear fuel through this lease was to avoid having to raise capital or to increase long-term debt. (Tr. p. 168)

68. In an order dated December 23, 1980, the ICC authorized the taxpayer to enter into the Fuel Lease with "CPFC. (Stip. #29, "CPC" Ex. #86)

69. In the December 23, 1980 order, the ICC found that “it is reasonable and appropriate to account for the Fuel Lease as an operating lease for accounting and ratemaking purposes” and ordered “Consolidated Power” to account for the Fuel Lease as an operating lease for accounting and ratemaking purposes.” (Stip. #30)

70. In the order dated December 23, 1980, the ICC ordered the taxpayer to account for the payments to “CPFC under the Fuel Lease during the operation of “ABC” Power Station by charging such payments to Operating Expense Account 518, Fuel. (Stip. #31)

71. In the order dated December 23, 1980, the ICC ordered the taxpayer to include the payments to “CPFC under the Fuel Lease that are charged to Operating Expense Account 518, Fuel, in the computation of the fuel adjustment charge under “CPC’s” fuel adjustment clause. (Stip. #32)

72. As of the end of 1996, the ICC has not canceled, revised or rescinded the authorizations granted in the December 23, 1980 order. (Stip. #33)

73. The ICC in 1992 issued another order that reaffirmed the accounting and ratemaking treatment that had been detailed in the 1980 order. (Tr. p. 236)

74. When the ICC established rates for the taxpayer, they consistently treated the Nuclear Fuel Lease as an operating expense and did not consider the capital lease obligation that had been reported as an asset to be included in the rate base, nor did they consider the capital lease obligation that was recorded in Account 227 as a component of the capital structure of the company, or as an element of long-term debt. This treatment continued even after the taxpayer was required to start recording and reporting its fuel lease as a capital lease and capital lease obligation on its balance sheet and even after the ICC revised its Uniform System of Accounts to provide for the recording and reporting of capital leases and obligations under the heading of

capital leases on the balance sheet. (Tr. pp. 237-238)

75. "CPC" did not include the noncurrent portion of its obligations under capital leases in the total for "long-term debt" shown on its Invested Capital Tax Return filed for any of the years 1979 through 1996. (Stip. #23)

76. The Department did not attempt to require the taxpayer to include the noncurrent portion of its obligations under the Fuel Lease or under any other lease in the "long-term debt" component of "invested capital" in computing invested capital tax due for any of the years 1979 through 1988. (Stip. #24)

77. SFAS No. 71, Appendix C, "Basis for Conclusions," at ¶¶ 51-54 states:

51. The FASB Discussion Memorandum, *Effect of Rate Regulation on Accounting for Regulated Enterprises*, presented a threshold issue: "Should accounting prescribed by regulatory authorities be considered in and of itself generally accepted for purposes of financial reporting by rate-regulated enterprises"?

52. Virtually all respondents to the Discussion Memorandum indicated that accounting prescribed by regulatory authorities should not be considered in and of itself generally accepted for purposes of financial reporting by rate-regulated enterprises. Respondents noted that the function of accounting is to report economic conditions and events. Unless an accounting order indicates the way a cost will be handled for rate-making purposes, it causes no economic effects that would justify deviation from the generally accepted accounting principles applicable to business enterprises in general. The mere issuance of an accounting order not tied to rate treatment does not change an enterprise's economic resources or obligations. In other words, the economic effect of regulatory decisions -- not the mere existence of regulation -- is the pervasive factor that determines the application of generally accepted accounting principles.

53. Respondents also noted that regulatory-prescribed accounting has not been considered generally accepted per se in the past.

54. The Board concluded that regulatory-prescribed accounting should not be considered generally accepted per se, but rather that the Board should specify how generally accepted accounting

principles apply in the regulatory environment. (Stip. #57; Tr. pp. 510-512)

78. SFAS No. 71, Appendix C, “Basis for Conclusions,” at ¶¶ 95-98 states:

95. Statement 13, as amended, specifies criteria for classification of leases and the method of accounting for each type of lease. For rate-making purposes, a regulator may include lease payments in allowable costs as rental expense even though the lease would be classified as a capital lease under the criteria of Statement 13. The Discussion Memorandum asked for views on the economic effects of that regulatory treatment and how to account for those effects.

96. A number of respondents indicated that the classification of a lease is not affected by the regulator’s actions. In their view, rate actions of the regulator cannot eliminate obligations to third parties unless the obligations were created by the regulator. Also, they observed that, over the term of a capital lease, the aggregate lease payments are equal to aggregate amortization of the leased asset and aggregate interest on the lease obligation. Thus, the regulator, by including the lease payments in allowable costs, establishes the existence of probable future benefits approximately equal to the combined amount of the capitalized leased asset and interest on the lease obligation over the term of the lease. In their view, regulated enterprises should classify leases in accordance with Statement 13 as amended. The Board agrees with that view.

97. Other respondents indicated that the regulator’s action establishes that there is no asset related to the lease. They indicated that an income statement display consisting of amortization and interest would mislead users if the regulatory process based rates on rental expense. In their view, regulated enterprises should classify leases in accordance with their classification for rate-making purposes. The Board concluded that such a view focuses on the mechanics of the rate-making process rather than on the economic effects of the process. This Statement requires that regulated enterprises account for the economic effects of the rate-making process; it does not attempt to portray the mechanics of that process in financial statements.

98. The Board concluded that the nature of the expense elements for a capitalized lease (amortization and interest) are not changed by the regulator’s action; however, the timing of expense recognition related to the lease should be modified to conform with the rate treatment. Thus, amortization of the leased asset would be

modified so that the total interest and amortization recognized during a period would equal the rental expense included in allowable cost for rate-making purposes during that period. Although this Statement requires the expense elements of a capitalized lease to consist of amortization and interest regardless of the regulatory treatment, the Board notes that generally accepted accounting principles do not require interest expense or amortization expense to be shown as such in an income statement. (Stip. #58)

79. Under SFAS No. 13, a lease may be recorded as a capital lease even though the lease obligation is not a legal debt. (Stip. # 63; Tr. pp. 317-318)

80. Under SFAS No. 13, a lease may be recorded as an operating lease even though the lease is legal debt. (Stip. #64)

81. Under SFAS No. 13, a lease may be recorded as a capital lease even though it is not a purchase transaction. (Stip. #65)

82. SFAS No. 13, Appendix B, "Basis for Conclusions," at ¶ 60 states:

The provisions of this Statement derive from the view that a lease that transfers substantially all of the benefits and risks incident to the ownership of property should be accounted for as the acquisition of an asset and the incurrence of an obligation by the lessee and as a sale or financing by the lessor. All other leases should be accounted for as operating leases. In a lease that transfers substantially all of the benefits and risks of ownership, the economic effect on the parties is similar, in many respects, to that of an installment purchase. This is not to say, however, that such transactions are necessarily "in substance purchases" as that term is used in previous authoritative literature. (Stip. #66)

83. SFAS No. 13 at ¶ 13 states:

Assets recorded under capital leases and the accumulated amortization thereon shall be separately identified in the lessee's balance sheet or in footnotes thereto. Likewise, the related obligations shall be separately identified in the balance sheet as obligations under capital leases and shall be subject to the same considerations as other obligations in classifying them with current and noncurrent liabilities in classified balance sheets. Unless the charge to income resulting from amortization of assets recorded

under capital leases is included with depreciation expense and the fact that it is so included is disclosed, the amortization charge shall be separately disclosed in the financial statements or footnotes thereto. (Stip. #67)

84. For each of the years beginning January 1, 1984, and ending December 31, 1996, "CPC" made a determination that the leases recorded on its balance sheets as capital leases met one or more of the criteria under SFAS No. 13 and the FERC Uniform System of Accounts for classification as capital leases. (Stip. #68)

85. Statement of Auditing Standards (hereinafter referred to as "SAS") No. 69 lists the hierarchy of authoritative pronouncements constituting GAAP. (Stip. #69; "CPC" Ex. #81)

86. SAS No. 69 states:

5. Independent auditors agree on the existence of a body of generally accepted accounting principles, and they are knowledgeable about these principles and in the determination of their general acceptance. Nevertheless, the determination that a particular accounting principle is generally accepted may be difficult because no single reference source exists for all such principles. The sources of established accounting principles that are generally accepted in the United States are -

- a. Accounting principles promulgated by a body designated by the AICPA⁴ Council to establish such principles, pursuant to rule 203 (AICPA, Professional Standards, vol. 2, ET sec. 203.01) of the AICPA Code of Professional Conduct . . .
- b. Pronouncements of bodies, composed of expert accountants, that deliberate accounting issues in public forums for the purpose of establishing accounting principles or describing existing accounting practices that are generally accepted, provided those pronouncements have been exposed for public comment and have been cleared by a body referred to in category (a).⁵
- c. Pronouncements of bodies, organized by a body referred to in category (a) and composed of expert accountants, that deliberated accounting issues in public forums for the purpose of interpreting or establishing accounting principles or describing existing accounting practices that are generally accepted, or pronouncements referred to in

⁴ American Institute of Certified Public Accountants

⁵ For purposes of this Statement, the word *cleared* means that a body referred to in subparagraph (a) has indicated that it does not object to the issuance of the proposed pronouncement.

- category (b) that have been cleared by a body referred to in category (a) but have not been exposed for public comment.
- d. Practices or pronouncements that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry, or knowledgeable application to specific circumstances of pronouncements that are generally accepted. ("CPC" Ex. #81)

87. GAAP is a technical accounting term that constitutes the policies, conventions, and practices that are generally accepted at a point in time. The phrase "generally accepted accounting principles" encompasses the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. The problem with generally accepted accounting principles is that there is not any one particular statement that a person might look at to arrive at a conclusion. A textbook or journal article can be used for guidance to constitute a part of generally acceptable accounting principles only if there are no other sources that are authoritative or not applicable. SAS No. 69, issued by the American Institute of Certified Public Accountants, outlines the documents one would look at to arrive at a conclusion. ("CPC" Ex. #81; Tr. pp. 205-206, 480, 488-489)

88. SAS No. 69 is intended to provide auditors with guidance as to what the term "generally accepted accounting principles" means in terms of their issuance of an opinion upon a set of financial statements. ("CPC" Ex. #81; Tr. p. 366)

89. The FERC Uniform System of Accounts and the ICC Uniform System of Accounts are part of the authoritative pronouncements constituting GAAP. (Stip. #70)

90. A search of authoritative literature indicates that capital lease obligations are not considered to be long-term debt. An evaluation and review of the requirements of the Uniform System of Accounts as adopted by FERC and the ICC indicates that capital lease obligations are not long-term debt. There is nothing in authoritative accounting literature which would require

capital lease obligations to be recorded as long-term debt or reported as long-term debt. The actions taken by the ICC have not created an economic asset or economic liability for the taxpayer and the ICC does not view these obligations to be considered debt in its rate-making determinations. ("CPC" Ex. #106, 111; Tr. pp. 194-206)

91. For the taxable years in question, the taxpayer recorded its obligations under Capital Leases-Non-current in the line labeled Long-Term Debt on its classified balance sheet in its annual report to shareholders. (Dept. Ex. #3-10; Tr. pp. 67-76, 252-254)

92. GAAP have a specific requirement with respect to reporting obligations under capital leases on the financial statement, *i.e.*, that they should be disclosed in the balance sheet or footnotes to the financial statements. A utility may present its amount for obligations under capital leases with the line item for long-term debt as the taxpayer did, but there is no requirement under GAAP that it must do so. (Tr. pp. 252-263)

93. For the taxable years in question, the taxpayer recorded its obligations under Capital Leases-Concurrent in the line labeled Long-Term Debt on its Form 10-K to the Security and Exchange Commission. (Dept. Ex. #11-18; Tr. pp. 67-76)

94. No SFAS issued by the FASB states whether or not the noncurrent portion of an entity's obligations under capital leases is long-term debt. (Stip. #71)

95. No SFAS issued by the FASB states whether or not the noncurrent portion of an entity's obligations under capital leases should be recorded as long-term debt. (Stip. #72)

96. No SFAS issued by the FASB states that the noncurrent portion of an entity's obligations under capital leases should be reported on its financial statements as long-term debt. (Stip. #73)

97. Other than the Invested Capital Tax return forms, the Department has issued no

rules, regulations, instructions or bulletins setting forth the amounts subject to the Invested Capital Tax, how to compute or calculate the amount of Invested Capital Tax, the items or amounts to be included in the “total long-term debt” component of “invested capital” for purposes of the Invested Capital Tax, and what information to report on the return forms. (“CPC” Ex. #75; Stip. #20)

98. Between 1991 and 1997 the Department held meetings regarding its treatment of the noncurrent portion of a utilities' capital fuel lease as included in long-term debt for purposes of calculating the utilities invested capital tax. On January 31, 1997, a memorandum was issued to various Department of Revenue employees which stated that a decision had been reached on how to proceed with the Invested Capital Tax audits. The audit bureau recommended, without objection from the legal services bureau, that the noncurrent portion of the utilities' capital fuel leases should be included in the Invested Capital Tax base. (“CPC” Ex. #94, 95; Tr. pp. 606-624, 626-633)

99. The Department has issued only three bulletins specifically directed to invested capital taxpayers: (1) on August 24, 1979, advising of the tax; (2) in October of 1991, advising of new legislation making the tax inapplicable to certain classes of persons; and (3) in August of 1992, advising of a change in the estimated payment form (ICT-1) and due dates for estimated payments of invested capital tax. (“CPC” Ex. #87, 88, 89; Stip. #21)

100. These three bulletins, specifically directed to invested capital taxpayers, did not instruct the taxpayers to treat the noncurrent portion of capital leases as long-term debt for the purposes of calculating their invested capital tax. (Tr. pp. 584-588)

101. Since the GRTA tax on invested capital became effective, the Department has not adopted any rules or regulations pursuant to §5-10 of the Administrative Procedure Act

(hereinafter referred to as the "APA"), 5 **ILCS** 100/5-10, implementing section 2a.1 of the GRTA. (Stip. #22)

102. The Department issued a letter ruling dated March 3, 1995, to Commonwealth Edison stating that its position was that capital leases are long-term debt. ("CPC". Ex. #99; Tr. p. 263)

103. Primarily, the purpose of regulatory accounting in the case of public utilities is for rate making. Even though the taxpayer's nuclear fuel lease is reported as an asset under the Uniform System of Accounts, it is not treated as an asset in the ratemaking process. (Tr. pp. 541-542)

104. Capital leasing is a means of financing, as is the issuance of first mortgage bonds. The taxpayer could have chosen, as an alternative to the capital lease arrangement, to purchase the fuel by issuing debt securities, long-term first mortgage bonds, or short-term debt to purchase the fuel outright. (Tr. pp. 498-499)

105. The taxpayer has resources such as deferred income taxes and investment tax credits that are reported as capital and liabilities on its balance sheet but they are not classified as long-term debt. (Tr. pp. 492- 496, 542)

106. The taxpayer filed amended Invested Capital Tax Returns on May 1, 1997, for the calendar years 1989, 1990, 1991, 1992, 1993, 1994, 1995, and 1996. On August 15, 1997, the taxpayer filed two Claims for Credit forms. The first was for \$3,000,000.00 for the period of December 1992 through December 1995 because "During 1992, 1993, and 1994, \$125,000,000 of short-term debt consisting of commercial paper and other short-term instruments, was classified as long-term debt on the ICC form 21. FERC pointed out in a recent audit that this debt should be restated as short-term debt." The second claim was for \$2,157,840.00 because "In

the March 3, 1995 letter from IDOR to Commonwealth Edison, the Department's attorney states 'According to accounting practice, long-term debt can be defined as likely future sacrifices of economic benefits arising from current obligations that are not payable within one year.' Although we contend in protest to IDOR issued ICT assessments that the ICT is based on GAAP applicable to public utilities subject to FERC jurisdiction, and we will continue to protest the assessments on that basis, we submit these corrections consistent with the IDOR's position for IDOR's immediate processing and approval." The reason the taxpayer submitted the claims was to better define the two issues raised by the submission of the amended returns. The issues raised were the basis of the claims as well as the amended returns. ("CPC" Ex. #98, 122)

107. The parties have calculated the amounts that would be due the Department as of August 26, 1999, if the Department prevails on the issue of the treatment of capital leases for purposes of the Invested Capital Tax. Those calculations include reductions in "CPC's" purported tax liability that the Department agrees should be made in order to reflect adjustments based upon the amounts of long-term debt maturing within one year for each tax year. The calculations for tax year 1992 also include a calculation of the effect on "CPC's" purported tax liability for that year attributable to the reclassification of \$125,000,000 as short-term debt by FERC. (Stip. # 125)

108. The parties have calculated the amounts that the taxpayer would be entitled to receive as refunds or credit memoranda if "CPC" prevails on all issues in this proceeding, including the issue relating to the 1992 tax year of the reclassification of \$125,000,000 as short term debt by FERC. The Department does not agree that "CPC" would be entitled to any refunds or credits if "CPC" prevails on the capital lease issue. (Stip. #126)

CONCLUSIONS OF LAW:

Section 2a1 of the Gas Revenue Tax Act (GRTA) provides in part as follows:

“Imposition of tax on invested capital. In addition to the taxes imposed by the Illinois Income Tax Act [35 **ILCS** 5/101 *et seq.*] and Section 2 of this Act, there is hereby imposed upon persons engaged in the business of distributing, supplying, furnishing or selling gas and subject to the tax imposed by this Act *** an additional tax in an amount equal to .8% of such persons’ invested capital for the taxable period.” 35 **ILCS** 615/2 *et al.*

Section 1 of the GRTA provides the definition of invested capital and states as follows:

“Invested capital” means that amount equal to (I) the average of the balances at the beginning and end of each taxable period of the taxpayer’s total stockholder’s equity and total long-term debt, less investments in and advances to all corporations, as set forth on the balance sheets included in the taxpayer’s annual report to the Illinois Commerce Commission for the taxable period; (ii) multiplied by a fraction determined under Sections 301 and 304(a) of the “Illinois Income Tax Act” [35 **ILCS** 5/301, 304] and reported on the Illinois income tax return for the taxable period ending in or with the taxable period in question. ****” (emphasis added) 35 **ILCS** 615/1.

In Illinois Power Co. v. Johnson, 116 Ill.App.3d 618 (4th Dist. 1983) (hereinafter referred to as "Johnson"), the Fourth District Appellate Court considered the issue of whether the figure for bonds should be adjusted when determining “total long-term debt” as a component of invested capital under the GRTA. In that case, the Department contended that the amount included under “total long-term debt” on taxpayer's balance sheet in its annual report to the Illinois Commerce Commission ("ICC") is the amount to be used in calculating the tax. The court rejected the Department’s argument and decided that in determining taxpayer’s total long-term debt for purposes of calculating the tax, certain adjustments should be made to the total long-term debt figure on the balance sheet. Specifically, the court determined that the total long-term debt amount must be (1) reduced by the unamortized discount and expense incurred upon the issuance of bonds and (2) increased by the unamortized premium realized on the issuance of bonds.

In its analysis, the Johnson court noted that the ICC balance sheet forms do not have an exact category titled either “total stockholder’s equity” or “investments in and advances to all corporations,” which are the other two elements of invested capital under the Act. Therefore, the phrase “as set forth on the balance sheet” does not refer to any particular line item on the balance sheet. The court decided to look beyond the plain words of the statute in order to ascertain the meaning of the phrase “total long-term debt.” The court stated that the language used to describe the components of invested capital “gives the general impression of a tax on the amount of money at least semi-permanently committed to the utility’s operation.” Johnson at 627. The court continued by stating that if a utility raised \$500 by selling a bond with a face value of \$1000, then the utility only has \$500 for use in its business even though it must have \$1000 when the bond is redeemed. By the time the bond is redeemed, the discount will have been offset against stockholder’s equity. The court also stated that when the ICC makes decisions that require knowledge of a utility’s long-term debt, it deducts the unamortized discount and expense and adds the unamortized premium. In making these deductions and additions, the ICC uses the figures “as set forth on the balance sheet.”

In the present case, when the Department calculated the taxpayer’s invested capital tax, the Department determined that the taxpayer’s noncurrent obligations under its Nuclear Fuel Lease with CPFC should be included in the “total long-term debt” component of the tax. The Department strongly argues that according to the “holding” in Johnson, invested capital includes “that amount of money which is at least semi-permanently committed to the operation of the utility.” (Department’s brief, p. 2) The Department claims that the noncurrent portion of the Nuclear Fuel Lease fits this definition.

The taxpayer argues that Johnson was concerned with how to **calculate the amount** of

long-term debt that resulted from the sale of bonds and what **amount** was subject to the tax. The court's holding was that the tax is to be determined by netting any unamortized premium, discount, or expense incurred upon the issuance of bonds. In Johnson, there was no dispute that the bonds at issue were long term debt.

In addition, the taxpayer contends that the single phrase relied upon by the Department does not rise to the level of a "construction" of the GRTA because the court stated that the language of the Act "gives the general impression" of a tax on the amount of money at least semi-permanently committed to the utility's operation. Johnson at 627. The use of the words "gives the general impression" indicates that the court did not intend this phrase to be a guidepost for all future invested capital tax determinations.

Moreover, the taxpayer claims that the Department's argument concerning the holding of Johnson is unreasonable because it would extend the tax to items that are indisputably not long-term debt or stockholder's equity. For example, accumulated deferred income taxes and investment tax credits are sources of capital that support long-lived assets on the asset side of the balance sheet, but the Department does not contend that they are long-term debt even though they may fit within the definition suggested by the Department. Also, a utility's long-term assets may fall under the Department's definition, which the taxpayer claims was clearly not intended by the legislature.

The Department's argument concerning the holding in Johnson is not persuasive. When the court noted that the language used to describe the components of invested capital "gives the general impression of a tax on the amount of money at least semi-permanently committed to the utility's operation" (Johnson at 627), it was supporting its conclusion that any premium, discount, or expense must be offset against bonds outstanding. Netting the amount of bonds

outstanding with the premium, discount, and expense relating to the issuance of the bonds results in a dollar amount that the utility actually has for investment in its business. This calculation is in accord with the “general impression” of the statute. Moreover, the court did not specifically state that the tax is imposed on money that is semi-permanently committed to the utility’s operations.

The holding in Johnson is more accurately characterized as follows: in determining total long-term debt under the GRTA, the figures on the balance sheet must be rearranged in such a manner as to make a determination that is consistent with GAAP and the practice of the ICC. The court initially noted this as the issue in the case (Johnson at 624), and then decided that the total long-term debt on the balance sheet must be adjusted for the premiums, discounts, and expenses incurred on the issuance of bonds. By netting these amounts, a figure is reached that more accurately reflects the amount of money that is available for investment in the business. The ICC makes the same adjustments when it makes a substantive decision requiring knowledge of the utility’s long-term debt.

It is difficult to accept the Department's characterization of the holding in Johnson when the court specifically states:

The issue thus becomes whether the legislature intended that "invested capital" be determined (1) by taking figures from the balance sheets referred to and then arranging the figures in such a manner as to make the determination consistent with accepted accounting principles and the practice of the Commerce Commission as asserted by the plaintiff, or (2) by accepting and using those figures in the format in which they are presented on the balance sheets, as asserted by the defendants. *Id.* at 624

and:

We conclude from both the unreasonableness of the results of defendant's construction and the general purpose of the statute that the legislature intended that long-term debt for purposes of this tax on invested capital be determined with the adjustments plaintiff has made on its return.

Id. at 629

In addition to relying on the court's decision in Johnson, "Consolidated" also argues that the Invested Capital Tax does not apply to capital lease obligations. It is undisputed that Illinois Power's Nuclear Fuel Lease is currently considered to be a capital lease, as opposed to an operating lease, under GAAP. Prior to 1976, all leases were accounted for as operating leases, and therefore not recorded on the balance sheet. In 1976, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 13, which recognized the concept that a lease that transfers substantially all the benefits and risks incident to ownership of the property should be accounted for as an asset and a related liability on the lessee's balance sheet. These types of leases are known as capital leases, and SFAS No. 13 provides four criteria for determining whether a lease is a capital lease. Public utilities, however, at that time, did not follow SFAS No. 13. Utilities followed the Addendum to Accounting Principles Bulletin No. 2, which provided that regulated businesses should follow the guidelines of the regulatory authority that had jurisdiction over them.⁶ In 1976, the ICC and the FERC did not have any accounting requirements for classifying capital leases⁷.

In 1979, the General Assembly enacted the Invested Capital Tax as an amendment to both the Public Utilities Revenue Act ("PURA") and the GRTA. The Invested Capital Tax was imposed solely on electric and gas utilities regulated by the ICC⁸. "Consolidated" filed returns under the GRTA for both its electric and gas operations⁹. The Invested Capital Tax was enacted as one of the replacement taxes for ad valorem personal property taxes pursuant to Art. IX, §5 (c)

⁶ Stip. #54

⁷ Stip #40, 49

⁸ Stip. #15

⁹ Stip. #16

of the Illinois Constitution. At the time of the enactment, all leases of utilities were operating leases.

In 1981, "CPC" entered into the Nuclear Fuel Lease. In 1982, the FASB issued SFAS No. 71, which required that public utilities record as capital leases those leases that meet the criteria of SFAS No. 13. In 1984, the FERC adopted an amendment to the Uniform System of Accounts that required utilities to account for capital leases in accordance with SFAS No. 13.

The taxpayer argues that because utilities were not required to record capital leases on their balance sheets until 1982, the General Assembly could not have intended capital leases to be long-term debt under the Invested Capital Tax when it was enacted in 1979. At the time that the Invested Capital Tax was enacted, public utilities recorded their leases as operating leases. Thus, when the General Assembly imposed the tax on the "total long-term debt" of public utilities "as set forth on the balance sheets included in the taxpayer's annual report to the Illinois Commerce Commission for the taxable period" (35 **ILCS** 615/1), obligations under capital leases did not appear on the balance sheets. In addition, although the Department audited the taxpayer's Invested Capital Tax returns for all years since 1979, the Department did not attempt to require "CPC" to include its noncurrent capital lease obligations in the long-term debt component of the tax for the years 1979 through 1988.¹⁰

The taxpayer also argues that the General Assembly could not have intended to tax capital leases because the Invested Capital Tax was a replacement tax rather than a revenue-generating tax. The mandate under Art. IX, §5© of the Illinois Constitution was to replace the value of the revenue collected under the abolished ad valorem personal property tax. Continental Illinois National Bank & Trust v. Zagel, 78 Ill.2d 387, 399 (1979). The taxpayer states that in order to estimate the amount of revenue that the replacement tax would generate, the legislature

had to know what was in the tax base. Because capital lease obligations did not exist under the applicable accounting rules for utilities in 1979, the General Assembly could not have intended capital leases to be part of long-term debt (i.e., the tax base) for purposes of the Invested Capital Tax. To conclude otherwise would change the tax from a replacement tax to a revenue-generating tax because including capital lease obligations as part of long-term debt increases the tax base.

The taxpayer claims that the decision in Illinois Bell Telephone Co. v. Allphin, 93 Ill.2d 241 (1982) supports its position. In Allphin, the Supreme Court addressed whether the Messages Tax Act applied to revenues from interstate messages. The court determined that the Act was ambiguous and looked at the legislative intent behind the Act to ascertain its meaning. At the time that the statute was enacted, a state could not tax interstate commerce. The court presumed that the legislature intended to enact a valid taxing statute, and stated that statutes are to be interpreted in a manner consistent with the state of the law at the time of their enactment. Allphin at 249. “The scope of a statute is fixed by the conditions which exist and the law which prevails at the time the statute is adopted.” *Id.* at 255. Because interstate messages could not be taxed at the time that the Messages Tax Act was passed, the court decided that they were not covered by the Act. The taxpayer claims that the present case is similar because at the time the invested capital tax was enacted, capital leases were not recorded on the balance sheets of public utilities. The taxpayer therefore argues that the GRTA should not be extended beyond what was taxed at the time it was enacted.

The Department argues that the scope of the GRTA encompasses any changes in the definition of long-term debt. The Department relies on the case of Square D Co. v. Johnson, 233 Ill.App.3d 1070 (1st Dist. 1992), where the court considered the effect of a change in Federal

¹⁰ Stip. #24

constitutional principles on the scope of the Use Tax Act. The court found that the Use Tax Act was neither ambiguous nor unclear, and therefore it was not necessary to construe legislative intent. The court found that the language of the Use Tax Act covered the change. The Department claims that the Square D case is similar to the instant case because the Illinois Power v. Johnson court determined the legislative intent behind the GRTA and that “in light of this judicial construction the law is clear and unambiguous¹¹.” The Department states that under Illinois Power v. Johnson, capital leases are long-term debt because they represent long-term financing of the cost of an asset.

In response, the taxpayer argues that Square D is distinguishable because that court relied directly on the words of the Use Tax Act to find that it was unambiguous. In the present case, the Department is not relying on the words of the GRTA, but rather on an interpretation of those words by the court in Illinois Power v. Johnson. In addition, the Illinois Power v. Johnson court stated that the meaning of “as set forth on the balance sheet” in the GRTA “can only be determined by delving beyond the plain words of the statute.” (Johnson at 626.) The Illinois Power v. Johnson court therefore determined that the statute is ambiguous regarding the adjustments necessary to the total face amount of the bonds outstanding.

Although the Illinois Power v. Johnson court found GRTA to be ambiguous, the court also determined what the General Assembly meant when it used the term “long-term debt.” The court found that the legislature intended long-term debt to be determined by rearranging the figures on the balance sheet in such a manner that is consistent with generally accepted accounting principles (“GAAP”) and the practice of the ICC. According to the court’s decision, any changes in GAAP are encompassed by the Act.

¹¹ Dept. brief p. 14

Therefore, the question that remains is whether the inclusion of capital leases in long-term debt would be consistent with GAAP and the ICC's practices. The taxpayer is subject to the jurisdiction of the Federal Energy Regulatory Commission and the ICC. The Federal Energy Regulatory Commission ("FERC") has established the Uniform System of Accounts with which utilities subject to its jurisdiction must comply. The ICC has adopted the FERC Uniform System of Accounts as its Uniform System of Accounts with minor differences not applicable here. The FERC Uniform System of Accounts and the ICC Uniform System of Accounts are virtually identical and their provisions concerning accounting for and reporting of capital leases and capital lease obligations are completely identical. The parties have stipulated that the FERC Uniform System of Accounts and the ICC Uniform System of Accounts are part of the authoritative pronouncements constituting GAAP.¹²

Consistent with the Financial Accounting Standards Board's issuance of SFAS 71 which requires utilities to begin to recognize and account for capital leases in accordance with SFAS 13, the FERC, in 1984, amended the Uniform System of Accounts to include provisions for classifying leases as capital or operating. Utilities subject to FERC's jurisdiction were required to implement these new accounting requirements beginning in 1987 for leases with inception dates prior to December 31, 1982, and in 1984 for leases with inception dates after December 31, 1982. This timing was consistent with the timing in SFAS 71 for implementation of its requirements.

The amended Uniform System of Accounts defines "Lease, capital" as "a lease of property used in utility or nonutility operations which meets one or more of the criteria stated in General Instruction 19." General Instruction 19, entitled "Criteria for Classifying Leases," sets forth the criteria for classifying leases as capital or operating. The criteria are identical to the

¹² Stip. #70

criteria in SFAS 13 for classifying leases as capital or operating. The instructions for accounting for leases found at General Instruction 20 state the record keeping responsibilities of a utility and mandate that the utility record the capital lease as an asset as appropriate in either account 101.1¹³, account 120.6¹⁴, or account 121¹⁵ and as an obligation in either account 227¹⁶ or account 243¹⁷ at an amount equal to the present value at the beginning of the lease term of minimum lease payments during the lease term, excluding the portion of the payments representing executory costs to be paid by the lessor, together with any profit thereon. Account 277 includes the noncurrent portion of the obligation under capital leases, not due within one year, of obligations recorded for the amounts applicable to leases properly recorded as assets in accounts 101.1, 120.6, or 121.

The Uniform System of Accounts includes a balance sheet chart of accounts that lists all accounts and the category into which each one falls. Under the balance sheet, Account 227 is in the category of "Other Noncurrent Liabilities." There is a separate category entitled "Long-Term Debt" that does not include account 227. The "Long-Term Debt" category includes accounts 221 through 226.¹⁸ Therefore, the Uniform System of Accounts does not specify that the noncurrent capital lease obligations are long-term debt or should be recorded as long-term debt. Instead, it explicitly requires the noncurrent capital obligations be recorded in an account that is not included in the long-term debt category.

Both parties have stipulated that under the FERC and ICC Uniform System of Accounts, noncurrent capital lease obligations are not recorded in the balance sheet category "long-term

¹³ Property under Capital Leases

¹⁴ Nuclear Fuel Under Capital Leases

¹⁵ Non-utility property

¹⁶ Obligations under Capital Leases-Noncurrent

¹⁷ Obligations under Capital Leases-Current

debt." It is significant that when FERC amended the Uniform System of Accounts in accordance with SFAS 13, they chose to create a new account, Account 227, entitled "Other Noncurrent Liabilities," as a separate place to report noncurrent capital lease obligations by utilities. They chose not to specify that noncurrent capital lease obligations should be recorded in one of the existing accounts, or a new account within the Uniform System of Account's long-term debt category even though the Uniform System of Account had at that time an existing long-term debt account entitled "Long-Term Debt" found at account 224. Had the FERC considered noncurrent capital lease obligations to be long-term debt, they would have included those obligations in account 224. Rather, they created a new account, Account 227, "Other Noncurrent Liabilities" for those obligations.

Likewise, the ICC Annual Report form contains balance sheets as well. These require the reporting of accounts recorded in the various accounts in the Balance Sheet Chart of Accounts of the Uniform System of Accounts under the category in which each balance sheet account is listed in the Uniform System of Accounts. Consistent with the amendments to the Uniform System of Accounts relating to capital leases, the ICC's Annual Report forms were revised for years beginning with 1984 to provide for the reporting of information in the new asset and liability accounts which were created for capital leases and capital lease obligations. As the parties have stipulated,¹⁹ on the ICC annual Report form, noncurrent capital lease obligations are not reported in the balance sheet category "Long-Term Debt." The forms for the Balance Sheet in the ICC Annual Report in effect for the years 1984 through 1996 listed "Obligations Under Capital Leases - Noncurrent (227)" under the category "Other Noncurrent Liabilities," which is a

¹⁸ Specifically those accounts include Bonds (221); [Less] Reacquired Bonds (222); Advances from Associated Companies (223); Other Long-Term Debt (224); Unamortized Premium on Long-Term Debt (225); [Less] Unamortized Discount on Long-Term Debt-Debit (226) equals Total Long-Term Debt.

¹⁹ Stip. #52

separate category from "Long Term Debt" on the Balance Sheet. The Balance Sheet forms in the ICC Annual Report in effect for the same years listed the following accounts as line items under the category "Long-Term Debt": Bonds (221); [Less] Reacquired Bonds (222); Advances from Associated Companies (223); Other Long-Term Debt (224); Unamortized Premium on Long-Term Debt (225); [Less] Unamortized Discount on Long-Term Debt-Debit (226) equals Total Long-Term Debt.

The ICC Annual Report form also includes various balance sheet supporting schedules which must be included in the utility's annual report. The section of the balance sheet for long-term debt references a supporting schedule on which is to be reported information on accounts 221 through 224 plus information on the dollar amounts of premium, discount, or expenses associated with each long-term debt issue. The supporting schedule for long-term debt does not require the reporting of any information regarding Obligations under Capital Leases-Noncurrent.

The parties have stipulated that the taxpayer properly recorded its noncurrent capital lease obligations on Account 227, "Obligations under Capital Leases-Noncurrent" on the Balance Sheets in its Annual Reports to the ICC in each year from 1984 through 1996. Therefore there is no dispute that "CPC" correctly reported the amounts of its noncurrent capital lease obligations in accordance with the Uniform System of Accounts and the ICC Annual Report forms for each of those years.

Sections 1 and 2a.1 of the GRTA impose the Invested Capital Tax on the utility's long-term debt and the stockholder's equity as set forth on the taxpayer's annual report to the ICC for the taxable period. The Balance Sheets in the ICC Annual Report forms for the taxable period at issue required the taxpayer to report, as it did, the amount of its obligations under capital leases on the line item for Account 227. The line was placed by the ICC on the balance sheet under

"Other Noncurrent Liabilities" rather than under the category "Long-Term Debt." There is no provision in the ICC annual report form that would tie or relate amounts recorded in account 227 "Obligations under Capital Leases-Noncurrent" to the category of "Long-Term Debt" on the Balance Sheet on the ICC Annual Report, or to any of the individual accounts in the "Long-Term Debt" category. In addition, there is nothing in the definitions of the accounts in which information on capital leases is to be recorded, or elsewhere in the Uniform System of Accounts, that characterizes noncurrent capital lease obligations as "long-term debt" or that links or relates capital lease obligations to any of the accounts for "long-term debt."

Taxing statutes are to be strictly construed, and their language is not to be extended or enlarged by implication beyond its clear import; in cases of doubt, such laws are construed most strongly against the government and in favor of the taxpayer. Ingersoll Mill. Mach. Co. v. Department of Revenue, 405 Ill. 367 (1950); *See also* Van's Material Co. v. Department of Revenue, 131 Ill.2d 196 (1989), Arenson v. Department of Revenue, 279 Ill.App.3d 355, 358 (2nd Dist. 1996). In construing a statute, the primary rule is to ascertain and give effect to the intent of the General Assembly, and that inquiry must begin with the language of the statute. Van's Material *supra* at 202.

The plain language of the statute says that the definition of invested capital in §1 of the GRTA includes total long-term debt as set forth on the balance sheets included in the taxpayer's annual report to the Illinois Commerce Commission for the taxable period. Johnson, *supra*, held that the phrase "as set forth on the balance sheet" does not refer to a particular line item on the balance sheet. Rather, it is necessary to look beyond the plain words of the statute in order to ascertain the meaning of the phrase "total long-term debt." The court found that the legislature intended long-term debt to be determined by rearranging the figures on the balance sheet in such

a manner that is consistent with GAAP and the practice of the ICC. According to the court's decision, any changes in GAAP are encompassed by the Act. In the instant case, neither the taxpayer's expert witness nor the Department's expert witness were able to establish that the non-current portion of the taxpayer's capital lease obligations are considered to be long-term debt under GAAP.

Although the Department asserts that the leases should be included in the long-term debt component, it has not established that this is consistent with GAAP, FERC, or ICC practices. The taxpayer's practice of including the leases in its long-term debt on its classified balance sheet in its annual report to shareholders is not determinative of whether the leases should be included in long term debt for invested capital purposes. Neither expert witness relied upon this practice to form their opinion in this matter. Both expert witnesses performed searches in authoritative pronouncements and were unable to find any persuasive authority to state that the non-current portions of the fuel leases at issue are considered long-term debt.

The Department asserts that there is no substantive difference between the accounting concept of long-term debt and non-current liabilities. This assertion fails to take into account the fact that other non-current liabilities, such as accumulated deferred income taxes, which fit the commonly understood definition of long-term debt are not classified as long-term debt. All parties agree that deferred income taxes are non-current liabilities, but no one asserts that they are long-term debts or should be included in the long-term debt category for GRTA or Invested Capital Tax purposes. The ICC balance sheet form 21 contains two separate sections with regard to long-term debt and non-current liabilities. Long-term debt is recorded in accounts 221, 222, 223 and 224; non-current liabilities are recorded on line 227. This obviously is an acknowledgement that there are two different classifications: long-term debt and non-current

liabilities. The taxpayer recorded its liability for the lease at issue on line 227. I find that there are substantive differences between the two terms, "long-term debt" and "non-current liabilities" and that the non-current portions of the lease at issue were not long-term debt.

In addition, the Department's own expert witness said that in his opinion, the fact that the taxpayer included the leases in its financial statements under the category of long-term debt was not determinative²⁰. On the financial statements, the taxpayer had the option of including the lease obligations in either the long-term debt component or noting it in a footnote on the balance sheet. The taxpayer has demonstrated that its obligations under its fuel lease are not long-term debt under any pronouncements of GAAP, or under the FERC or ICC Uniform System of Accounts, and are not treated by the ICC as long-term debt or invested capital for any substantive purpose. The Department has failed to establish that the noncurrent portion of the fuel leases at issue should be included in the taxpayer's long-term debt for the purposes of the Invested Capital Tax.

An additional issue raised by the taxpayer in its brief is whether it is entitled to credit memoranda or refunds if it prevails on the capital lease issue. The taxpayer filed amended Invested Capital Tax Returns on May 1, 1997,²¹ for the calendar years 1989, 1990, 1991, 1992, 1993, 1994, 1995, and 1996. The taxpayer asserted in the cover letter with the corrected returns that they were being issued because:

1) \$125,000,000 of short-term debt was classified as long-term debt on the Form 21 for 1992, 1993, and 1994. FERC pointed out in a recent audit that this debt should be restated as short-term debt.

2) In the March 3, 1995 letter from IDOR to Commonwealth Edison, the Department's attorney states "According to accounting practice, long-term debt can be defined as likely future sacrifices of economic benefits arising from current obligations that are not payable within one year." Although we

²⁰ Tr. pp. 433-441, 536-537.

²¹ "CPC" Ex. #98

contend in protest to IDOR issued ICT assessments that the ICT is based on GAAP applicable to public utilities subject to FERC jurisdiction, and we will continue to protest the assessments on that basis, we submit these corrections consistent with the IDOR's position for IDOR's immediate processing and approval.

On August 15, 1997, the taxpayer filed claims for credit for the same periods for the reasons listed above. In its brief and reply brief, the taxpayer asserts that the claims were filed more than two years before this hearing, that other components of the May 1, 1997 claims for credit were ruled upon, but that DOR did not act on the claim relating to the portion of long-term debt due within one year because the taxpayer was advised by the Department that it would be left for this hearing. The taxpayer then asserts that the other unresolved item is the \$125 million of short-term debt erroneously classified as long-term debt for the tax year 1992 and that the Department does not contest this item in its memorandum.²² In fact, the Department expressly addresses the refund and credit memoranda in its Memoranda²³ filed on February 17, 2000.

The GRTA states the process for handling claims for credit at §6. That section of the statute provides the procedures to be followed by a taxpayer who wishes to obtain tax, penalty, or interest, which has been paid in error.

That section of the statutes states:

If it appears, after claim therefor filed with the Department, that an amount of tax or penalty or interest has been paid which was not due under this Act, whether as a result of a mistake of fact or an error of law, *** then the Department shall issue a credit memorandum or refund to the person who made the erroneous payment.***

Claims for credit or refund shall be filed upon forms provided by the Department. As soon as practicable after any claim for credit or refund is filed, the department shall examine the same and determine the amount of credit or refund to which the claimant is entitled and shall notify the claimant

²² See "CPC" Initial Post-Hearing Brief pp. 49-50, "CPC" Post Hearing Reply Brief pp. 47-49.

²³ See Memorandum of the Department of Revenue pp. 23-23

of such determination, which amount shall be prima facie correct. 35 **ILCS** 615/6

The taxpayer submitted claims for refund that were predicated upon the Department's letter issued on March 3, 1995, in which the Department took the position that the capital leases at issue should be included under the long-term debt provision of the Invested Capital Tax. An additional amount was asserted to be due because the FERC had determined that the taxpayer included \$125,000,000 in short-term debt as long-term debt.

The Department has not acted upon those claims pending the outcome of this hearing. Sections 6b and 6c of the Retailers' Occupation Tax Act, 35 **ILCS** 120/6b and 35 **ILCS** 120/6c, incorporated into the GRTA at 35 **ILCS** 615/5²⁴ explain the further processes in a claim for credit. Those sections state:

§6b. As soon as practicable after a claim for credit or refund is filed, the Department shall examine the same and determine the amount of credit or refund to which the claimant *** is entitled and shall, by its Notice of Tentative Determination of Claim notify the claimant or his legal representative of such determination, which determination shall be prima facie correct. Proof of such determination by the Department may be made at any hearing before the Department or any legal proceeding by a reproduced copy of the Department's record relating thereto, in the name of the Department under the certificate of the Director of Revenue. Such reproduced copy shall, without further proof, be admitted into evidence before the Department or in any legal proceeding and shall be prima facie proof of the correctness of the Department's determination, as shown therein. If such claimant, *** within 60 days after the Department's Notice of Tentative Determination of Claim, files a protest thereto and requests a hearing thereon, the Department shall give notice to such claimant, *** of the time and place fixed for such hearing, ***. 35 **ILCS** 120/6b

§ 6c. If a protest of the Department's Notice of Tentative Determination of Claim is not filed within 60 days and a request for hearing thereon is not made as provided in Section 6b of this Act, the said Notice shall thereupon become and operate as a Final Determination; ***. Claims for credit or refund hereunder must be filed with and initially determined by the

²⁴ The taxpayer is correct that the GRTA did not include the reference to §6b and c of the Retailers' Occupation Tax Act until it was amended in 1997. However, Section 6 of the GRTA, which deals with claims for credit, was enacted at the inception of the Gas Revenue Tax Act. See Laws 1945 p. 1235 §6.

Department, the remedy herein provided being exclusive; and no court shall have jurisdiction to determine the merits of any claim except upon review as provided herein. 35 ILCS 120/6c

The Department never determined the amount of credit or refund to which the taxpayer was due pursuant to the claims filed by the taxpayer, and never issued a Notice of Tentative Determination of Claim.²⁵ Thus, the taxpayer never, within 60 days of the non-existent Department's Notice of Tentative Determination of Claim, protested the notice because such a notice was not issued.

It is clear that the procedure provided by the statute is the exclusive and sole remedy in the case of claims for credit. It is the Tentative Determination of Claim that establishes the Department's position and provides my jurisdiction over the claims. Since there is no Notice of Tentative Determination of Claim, and certainly no statutorily provided for protest of same, the only issue that I have jurisdiction over in this matter is the legal question of whether the present value of future lease payments under the taxpayer's capital lease obligations for periods beyond the current year is long-term debt under the GRTA. Therefore, I agree with the assertion of the Department that the determination of the claims for refund must wait until the statutory prerequisites have been met.

It is therefore recommended that the present value of future lease payments under the taxpayer's capital lease obligations for periods beyond the current year is not "long-term debt" under the GRTA. In addition, I have not ruled on the claims submitted on August 15, 1997, because pursuant to the statute I have no jurisdiction to do so.

²⁵ It is reasonable to conclude that the reason that the Department did not act on the claims for credit submitted by the taxpayer was because it awaited a ruling on the claims' underlying issue of whether the present value of future lease payments under the taxpayer's capital lease obligations for periods beyond the current year is long-term debt under the GRTA. This in fact, is the very issue of the instant matter.

April 19, 2001

Barbara S. Rowe
Administrative Law Judge

APPENDIX

ACRONYMS USED IN DOCKET No. 95-ST-0000

APA - Administrative Procedures Act (5 ILCS 100/5-10)

APB - Addendum to Accounting Principles Bulletin

FASB - Financial Accounting Standards Board; Issues SFASs

FERC - Federal Energy Regulatory Commission

GAAP - Generally Accepted Accounting Principles

GRTA - Gas Revenue Tax Act

ICC - Illinois Commerce Commission

"CPFC" - "Consolidated Power Fuel Company" (the fuel lease is with "CPC"FC)

PURA - Public Utilities Revenue Act (35 ILCS 620)

SAS - Statement on Auditing Standards; issued by the Auditing Standards Board of the American Institute of Certified Public Accountants; No. 69 issued in January 1992; explains what the phrase "generally accepted accounting principles" means.

SFAS - Statement of Financial Accounting Standards; SFAS No. 13 entitled "accounting for leases" was issued in November 1976 and defines capital leases and the criteria used in the definition. It is substantially identical to the criteria for classifying leases set forth in FERC Uniform System of Accounts General Instruction 19; SFAS No. 71- issued in Dec. 1982 - entitled Accounting for the Effects of Certain Types of Regulation, required public utilities to record as capital leases (ii) commencing with fiscal years beginning after 12/15/86, those leases with inception dates prior to 12/31/82, in each case meeting the criteria of SFAS #13 to be classified.